Weekly Digest

| 22 June 2020 |

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The Next Wave

If ever there were something to illustrate that the gradual easing of lockdown measures leaves us far from what could be described as normal, it has been the odd experience of watching live coverage of football matches being played in empty stadia. Usually this only happens to clubs who have been sanctioned for crowd disturbances, for example. Test match cricket will also resume next month, although followers of the County Championship will be more used to the thwack of willow on leather reverberating around spectatorless stands. Even so, the resumption of hostilities on the field represents another step in the right direction for the economy.

Last week, in England at least, many non-essential shops opened their doors again, although, to judge by the queues, certain brands of luxury handbag are entirely essential. There is rising optimism within the hospitality industry that the two-metre rule for social distancing will be eased this week ahead of the next stage of re-opening. What all of this means is that short-term activity data is going to look very healthy in terms of month-to-month growth. Not only are we going to have suffered the deepest recession in modern history, but also, in all probability, the shortest. However, that rather underplays the fact that actual economic activity will remain well below previous levels for some time to come.

One of the best proxies for the evolution of economic growth relative to expectations is Citigroup's Economic Surprise Index, which the bank publishes for all of the main regions. A reading above zero tells us that data releases are running ahead of consensus expectations, while one below zero shows that economists have been too optimistic (or sometimes just too slow to react, which may well have been the case this year). For the UK, this series shows some evidence of the fabled "Boris Bounce" early this year following the Conservatives' election victory. The index rallied from -58 in mid-January to a peak of 76 in mid-March. Then, following the lockdown, it plunged (and that's not being sensational) to -140, before staging a recovery to a current -74. That's about where we were in the midst of the Eurozone crisis in 2011, and, you might be surprised to learn, still lower than during the trough of the financial crisis in early 2009, when the index bottomed at -67.

This picture is being replicated around the world. China's index has risen from a low of -239 to +38. The United States has gone from a low of -144 to +128. The Eurozone looks more like the UK, rising from a low of -304 to -186. However, we know that markets tend not to focus on absolute numbers but on the rate of change (or second derivative), thus the reverse from vertiginous drop to something less nauseating has been a positive factor for increasing risk appetite. Of further assistance has been the first sighting of upgrades

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to economists' forecasts for GDP growth as they judge the initial bounce to be a more "V"-shaped than expected.

Helping to make markets more sensitive is the fact that we now have access to much more real-time, high-frequency data than historically, and the higher the frequency of observations, the higher the volatility tends to be. Much of this is taken from mobile phone apps, and mapping and route request data has been very useful in assessing traffic levels, for example, a good proxy for overall activity. Restaurant booking apps have been another source of information about the pace of post-lockdown growth, although I am unsure of what to infer from the fact that restaurant bookings in Germany are higher than a year ago. I suspect that more restaurants and diners are using the apps in a world of reduced capacity, management of contacts and the uncertainty of getting a table on a "walk-in" basis.

Unfortunately this sets up a potential problem. If investor behaviour is consistent, a deceleration of improving data, even if still positive in absolute terms, will not be greeted with the same degree of enthusiasm. The same applies to both fiscal and monetary policy. Unless governments and central banks can continue to provide ever-increasing stimulus and policy surprises, markets will struggle to retain their impetus.

This is not necessarily bad news for markets, and we are not suggesting that policy will be anything other than very loose for some time to come. Central banks are committed to providing as much liquidity as required, and very cheaply. Although none have yet put a specific date on when they might start to raise interest rates, estimates are being made. For example, Goldman Sachs thinks that if the US Federal Reserve is to stick to its mandate of targeting core inflation of 2% and creating full employment, then US interest rates are not going up until 2025 at the earliest. It's hard to see other central banks wanting to go first unless they are encountering major inflation problems, which don't look probable for now. The Bank of England has suggested that it will reduce the size of its balance sheet before raising rates.

One theme running through several recent conference calls I have been on with both institutional fund managers and investment bank strategists is that riskier assets will continue to be supported by the lack of returns generated by "safe" assets such as cash and government bonds, notably from an income perspective. The acronym "TINA" is back – there is no alternative [to equities]. US Money Market Mutual Funds represent a huge potential source of demand. Assets in this sector jumped from $3.6 trillion at the start of the year to a peak of almost $4.8 trillion in May, but are now starting to leak back into riskier assets. Not only do these funds yield next to nothing, but there is an outside threat that US interest rate could turn negative.

Meanwhile the Covid-related data took a distinct turn for the worse last week, with worrying new outbreaks in China and Germany, as well as an acceleration of cases in a number of US states and the ongoing crisis in Brazil. The good news in China and Germany is that the cases are isolated and that the local response has been aggressive. Both countries also have a good record in dealing with the virus so far. The situation in the US is of greater concern, although the key point is that medical facilities are not being overwhelmed (so far). We also have to factor in that as testing becomes more widespread, the incidence of new cases will rise. It feels as though we are entering the "learning to live with the virus" phase. This means ongoing precautionary measures that will curtail a full economic recovery, and we don't rule out some form of rolling localised lockdowns. However, one of the conclusions reached at the latest meeting of our Global Investment Strategy Group – and I emphasise that this is no more than a collective opinion – is that governments do not have the appetite (or, in some cases, the political capital) to reimpose new total lockdowns. That should, at least, mean that the bottom is firmly in as far as overall economic activity is concerned.

Last week's Economic Highlights

FTSE 100 Weekly Winners

Ashtead Group	15.9%
SSE	12.0%
Bunzl	11.6%
Scottish Mortgage IT	11.0%
Smurfit Kappa	9.6%
United Utilities	8.4%
Mondi	8.3%

FTSE 100 Weekly Losers

Barratt Developments	-3.3%
BHP Group	-3.3%
Rio Tinto	-2.8%
Land Securities	-2.2%
Legal & General	-2.0%
British Land	-1.9%
Burberry Group	-1.9%

FTSE 100 Index, Past 12 Months

Source:FactSet

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